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Mergers and concentration

Backgrounder

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MERGERS AND CONCENTRATION

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INTRODUCTION

In order to provide a framework for the four industries analyzed later, the first section of this paper discusses the role that competition can and cannot play in ensuring economic efficiency. The second section defines different types of mergers. The term "merger" will be used generally to mean merger, takeover, or acquisition. The next four sections put the recent large merger proposals in the airline, brewing, oil, and pulp and paper industries into the historic context of competition and efficiency in those industries. The next section looks at the level of concentration in Canada. The paper concludes with a discussion of the policy implications of mergers and concentration in Canada.

COMPETITION, EFFICIENCY, AND CONSUMER SOVEREIGNTY

Every country has to decide how to organize its economy. There are some goods and services, such as health care, primary and secondary education and legal defence against criminal charges, to which the public feels people of all income levels should have equal access. The goods included in this list will vary from country to country.

We have no moral objection to allowing the remaining majority of goods to be distributed by the marketplace on the basis of ability-to-pay, with consumers deciding on the quantity of each good they purchase, although we might, of course, have some desire to see ability-to-pay more equitably distributed. The policy problem is to decide upon appropriate objectives for the marketplace and then to see what guidelines and rules will ensure that these objectives are met.

Resources are scarce and should therefore be used prudently. We require that the economic system produce without waste or slackness. Another reasonable requirement is that the marketplace faithfully convert the consumers' desires into production, ensuring that the consumer is sovereign.

The question is what sort of competition will simultaneously ensure both efficient production and consumer sovereignty. The link between competition and consumer sovereignty is the easier to explore. In a competitive marketplace the way to increase sales is by better meeting consumer wants. To understand the somewhat more complicated link between efficiency and competition, it is necessary to consider some technical terms.

Economists often discuss "average cost," which is just the total cost of producing output divided by the number of units of output. How average cost changes as the level of production changes will depend on the particular technology used in production. For most industrial products, it is expected that the average cost would be high for small output levels, dropping as the scale of output increased and then eventually increasing as the plant facilities were put under too high a pressure. This is known as the U-shaped average cost curve. The socially efficient level of production is at the lowest point of the U-shaped curve. We shall leave aside the question of whether there is a competitive price system which would force all producers to reach this point. If increasing output did not become increasingly difficult, then the average cost curve would not be U-shaped, but instead would continue to decline. An example of this might be an already wired telephone system; as the number of customers goes up, the average cost goes down because the fixed costs of the network and the exchange switching equipment are spread over a wider base. For an industry with this sort of cost structure, monopoly is efficient; forcing competition onto such an industry would result in a costly duplication of fixed plant.

The model of "perfect competition," in which competition enforces efficiency, is the oldest in economic theory. In its simplest form it requires a large number, technically infinite, of competitors in

each market. Because firms are so small relative to the market, each individually feels that it can select its output level without affecting the market price and will therefore select the output level that offers the opportunity for the best profit, which is the minimum cost level of output. The entry of new firms attracted into the market by high profit will thwart any attempts to charge excessive prices. The end result is that every firm produces at minimum cost, i.e., efficiently, and earns a competitive return on capital.

As a model to be used for public policy purposes, however, perfect competition is defective. Whether the minimum cost output level in a particular industry is small enough for a large number of firms to be supported depends on technology. What policies should a government implement in those industries where technology does not have this effect? The prospect of breaking up efficient-sized firms in order to create more competition is far from attractive.

"Perfect contestability" is a recent model of competition that has more policy implications. Imagine that a typical firm has a U-shaped average cost curve, and that there is no difference between the average cost of producing at the current level and the average cost of producing at the level the firm could expect to sell if there were one more firm in the industry. Visually, the average cost curve has a very flat bottom. In addition, suppose that outside firms can easily enter the industry; in technical terms, there are no barriers to entry. If the existing firms in the industry tried to charge a price above minimum average cost to earn an excess profit, outside firms would be immediately attracted into the industry and the excess profit would be lost to competition. Thus, the threat of outside competition, of "hit-and-run" competition, will discipline the existing firms to price at minimum average cost. Contestability does put restrictions on the technology of production. Moreover, a flat bottom to the average cost curve is much more plausible than the perfectly competitive condition which requires small scale operations to be very efficient. The automobile and food processing industries are examples of industries with flat-bottomed average cost curves.

Contestability, unlike perfect competition, does provide a benchmark to judge industries containing relatively few firms. It focuses attention on such observable phenomena as the cost relationships and barriers to entry, which makes the theory quite practical to use. The Competition Act does not oblige the Director or the Tribunal to use a contestable markets approach or any other approach, but it does rule out the use of market share or concentration ratios.

TYPES OF MERGERS

Mergers are classified as either horizontal, vertical or conglomerate. Horizontal mergers are those between firms serving the same market. Vertical mergers are those between firms which handle the same good at different stages in the production process; an example would be a merger between a forestry company and a lumberyard. Conglomerate mergers are those between companies whose product lines are not related. A merger between two large corporations with many product lines may have elements of all three kinds of merger.

The Competition Act will not disallow any pure conglomerate mergers because they imply no change in the level of competition in any of the markets served. Horizontal mergers, by their definition, imply the possibility of some reduction in competition and present the Director and the Tribunal with difficult decisions to make. Vertical mergers may be disallowed under the Competition Act if they would reduce competition. Although not strictly speaking a vertical merger in itself, the proposed merger of airline computer reservation systems discussed below does illustrate the problems of mergers downstream in the marketing of a product.

The motivations of merging firms will vary with the type of merger. In horizontal mergers, firms have technical expertise that can be transferred, and plant and operations can be rationalized. In vertical mergers firms have the opportunity to secure lines of supply. Explaining conglomerate mergers is somewhat harder. By definition, the products made by the merging firms are unrelated and unconnected. The usual argument is

that there is a market for corporate control between competing managerial teams. The takeover involves the replacement, or partial replacement, of one team of generalist managers with another.

Appendix Table 1 presents merger data for Canada, Germany, Japan and the U.S. It is interesting to note that all four countries show a recent boom. Horizontal mergers are quite a sizeable component in all countries, although the reader is cautioned about the nature of the Japanese statistics. There is some evidence of a cycle in mergers in all four countries.

THE PWA-WARDAIR MERGER

On 19 January 1989, PWA, which operates Canadian International Airlines, announced a takeover offer for Wardair, bidding $17.25 for Wardair shares that had previously been selling at between $8 and $9. Max Ward was to sell his family stock holdings in Wardair, amounting to 30% of the outstanding shares. The result of this merger, if approved, would be to reduce the number of longhaul national carriers to two. Table 1 gives the 1987 market shares.

TABLE 1

**The Canadian Airline Industry
Market Shares (%) 1987
(Revenue Passenger-Kilometres)**

Air Canada	50
CAI	37
Wardair	8
Independents	5

Source: Transport Canada Aviation Forecasts 1988-2001, TP7960.

Although Wardair's market share has been quite small, its plans have not. Max Ward saw that deregulation of the airline industry would allow his company to switch from being an international charter company to being a full schedule national carrier. These two areas of

airline business are quite different. The international charter business makes money by filling large aircraft, such as the Boeing 747 with 456 seats or the McDonnell Douglas DC-10 with 300 seats, so as to economize on fuel and fixed costs. Charter companies fly large numbers of passengers to one destination relatively infrequently. There is not the level of demand on domestic scheduled services to support such large aircraft at the flight frequency needed to attract customers. Wardair has had to change from a small number of large aircraft to a larger number of medium-sized aircraft. Wardair has commitments to acquire 11 Airbus A310-300's in 1988 and 1989 for $870 million and 8 McDonnell Douglas MD-88's in 1989 and 1990 at a cost of $325 million. To put these amounts into perspective, Wardair's long-term debt was $208 million in 1986 and $293 million in 1987 and as a consequence, Wardair was carrying a debt-to-equity ratio of over 2:1. Since the failure to repay debt triggers bankruptcy or the loss of control of the enterprise, a reliable cashflow is a necessity for a firm with a high debt-to-equity ratio. Wardair is reported to have lost $57.7 million on operations in 1988. These financial details provide some answers to why Wardair is experiencing difficulties at this moment, but do not address the long-term issues of competitiveness in the airline industry.

Airlines are a risky business, and there are plenty of examples of Canadian airlines taking risks that did not pan out. Nordair at one time served Pittsburg and Eastern Provincial, originally a Maritimes local carrier, at one time extended its service into Toronto. Such examples underline the fact that the airline market under deregulation is to some extent contestable. The policy question is whether it is sufficiently contestable.

Appendix Figure I shows the commercial relationships between the Level I airlines, Air Canada and CAI, and their affiliates. These airlines carry local traffic, and also act as feeders for the national carriers. They coordinate their schedules with those of the national carriers to provide convenient connections, arrange for adjacent gates at connecting airports where possible and allow baggage to be checked straight through. In the majority of cases, the national carriers have an ownership

interest in their affiliates. In two cases they just "codeshare," which means the affiliates share flight codes with the national carriers and have ticket envelopes with the national carrier's logo prominently displayed.

From the customer's point of view affiliation arrangements are probably beneficial: connections are made more conveniently, through-checked baggage is possibly less likely to be lost than baggage transferred between airlines, and national carriers are more likely to hold up their planes if one of their affiliated feeders, rather than some other connecting airline, is delayed. Thus, it is quite reasonable to argue that large-scale operations are desirable in the airline industry, and that if it continued as a separate carrier, Wardair would have an uphill battle since it would find it difficult to have the same convenient feeder connections as its two competitors.

Some more technical analyses, e.g. D. Gillen et al., "Identifying and Measuring the Impact of Government Ownership and Regulation on Airline Performance," The Economic Council of Canada, 1987, do suggest that the cost structure of a modern airline is such that the Canadian market can support only two major carriers. In terms of our earlier analysis, the U-shaped average cost curve does not have a flat enough bottom to be perfectly contestable. There are, however, some reasons to fear that the big two are not behaving as competitively as they might.

The frequent-flyer programs tend to make the market less contestable in some ways. They attempt to build airline loyalty, which will reduce the amount of shopping around by customers; the flyer may not be attracted by a lower price of ticket from a competitor airline because by using it he would lose frequent-flyer points. In addition, the frequent flyer plans are no use to the infrequent air traveller who will not be able to accumulate enough points for a prize. Finally, the plans are a barrier to entry because a new entrant without an overseas route would have to pay for bonus point holders to fly abroad on another carrier. Operators with foreign routes use the frequent-flyer bonus passengers to fill up otherwise empty seats at a low marginal cost.

The Director of Investigation and Research has already filed an application with the Competition Tribunal to disallow the merger of the Air Canada's Reservec and Canadian Airlines International's Pegasus computerized reservation systems into a single system to be known as Gemini and operated as a joint partnership.

Computer reservation systems allow travel agents to gain up-to-date information on airline schedules, seat availability and fares. As well as booking flights, travel agents can also reserve hotel rooms and rental cars. The Reservec system was used by 72% of travel agents who had a computerized reservation system in June 1987, Pegasus by 18%, and Sabre, owned by American Airlines, by 10%. Overall, 90% of travel agencies, which account for 70% of airline ticket sales, had computerized reservation systems.

The policy concern with computerized reservation systems is that any airline that owns such a system will attempt to obtain an advantage for itself and its affiliates in its handling of information. It might ensure that its own flights are always shown first on the screen, or limit competitors' ability to update fare information, so that they could not clear inventory by offering additional reduced fares close to flight time.

Canadian Airlines International has argued that the merger of the two computer systems would improve competition in the airline industry, because it would be given better access to Air Canada's Reservec clientele. Rather ironically, before its proposed merger with Canadian Airlines International, Wardair had applied for intervenor status in the Competition Tribunal hearings in April 1989.

The proposed merger of Wardair and Canadian Airlines International presents the competition policy watchdogs with a number of interesting problems. The reservation system merger proposal is now put in a very different light. There is sound reason for hoping the Director and the Tribunal find some way to treat the PWA-Wardair and Reservec-Pegasus mergers together. If the airline merger is allowed, then the case for disallowing the reservation merger or even forcing divestiture is stronger.

If the Canadian airline marketplace can just support a duopoly, then only the government can decide on policy options to maintain competitive fares, such as allowing limited U.S. carrier penetration into the Canadian market in exchange for further Canadian landing rights in that country.

THE MOLSON-CARLING O'KEEFE MERGER

A. Background

Close attention to proceedings in the Canadian brewing industry is understandable, given the popularity of beer - if Hockey Night in Canada is an institution then beer and ale are institutional beverages. Hence public response was immediate when Molson Breweries and Carling O'Keefe, numbers two and three in the Canadian market, announced in January 1989 their intention to merge to form Canada's largest brewing firm. The proposed firm would be half controlled by Elders IXL of Australia, which already owns Carling. Why this merger has come about and what it says about the brewing of beer in Canada will be explored in this section.

The current structure of the Canadian brewing industry is, to some extent, the result of early Canadian dalliance with prohibition. Regulatory jurisdiction over the industry was established under the once prevalent notion that alcoholic beverages should not be treated as a consumer good like any other. It is the purpose of this section to show how this affected the productivity of firms and the industry as a whole and created an environment conducive to high levels of concentration.

Experiments in regulating beer consumption had been undertaken at the local level in the nineteenth century, but it was only after World War I that provincial Prohibition became dominant in Canada. Beer drinkers were victorious at the end of the day, for by 1930 all provinces which had prohibited retail sale of alcoholic beverages (in Quebec, only liquor was so restricted) had reverted to "wet" status. The exception was Prince Edward Island, which managed to stay "dry" from 1902 to 1948.

Prohibition has given way to the milder desire to control alcohol consumption which, rather surprisingly, has governed the post-

Prohibition structure of the brewing industry. While production was at least principally controlled by the largely independent brewers and distillers, retail sale was left firmly in the hands of the provincial governments. This was an outcome of the Canadian Temperance Act of 1878. While not mandated by the BNA Act, the assumption of provincial control over beer distribution was the result of the proclamation of the 1878 Act. Further, all forms of promotion - advertising, packaging and distribution - were provincially controlled, and the distribution system itself was occasionally provincially owned. This pattern of regulation has affected market structure, as will be seen.

Attitudes toward alcohol have apparently affected the attitude toward regulation: interference in the market's economic structure and pricing policy has been tolerated to degrees unknown in the general realm of consumer products. Some policies have acted directly against the interest of consumers, if such interest can correctly be described as the wish for high availability and low prices. Such policies have occasionally acted against the interests of the industry itself, though even then the brunt of the burden may ultimately have been borne by consumers.

It should be noted, of course, that, in fact a "cheap beer" policy is not generally accepted to be necessarily in the best interest of Canadians. The costs associated with excessive alcohol consumption are known to be high, and lowered prices could naturally be expected to lead to higher consumption. High taxes on alcohol consumption - and taxes are by far the highest component of the retail price of all alcoholic beverages - thus meet the twin goals of restricting consumption and generating government revenue. Whether or not tax policy has a direct effect on industry structure is unclear, but industry regulation in general does have readily apparent effects on the market.

The effects of regulation have been manifold. Even the removal of temperance laws brought industry turmoil as a previously restricted market suddenly became relatively open. Market entrants were numerous; uncertainty over the size of the market and occasionally

unrealistic assessments of the probability of success led to the installation of excess capacity. The downturn in commerce associated with the depression years contributed to the market turbulence and the 1930s brought a large number of mergers and closures of small or inefficient breweries.

The most onerous of the various regulations affecting the brewing industry are those respecting plant location. In general, in order to sell beer in a particular province, the firm must operate a manufacturing facility in that province. Inter-provincial shipment of finished beer is restricted by all the provinces except Prince Edward Island, which has accepted that the natural beer market is, in the regional sense, larger than its boundaries. Whether the natural market for beer is larger than any province is obviously a relevant issue.

The market for beer (the "relevant market") is an issue that has been much discussed by economists over the years. There certainly is a loose regional demarcation for a particular plant; beer is a relatively high volume, low value good and high transportation costs and limited shelf-life militate against a single plant serving a very large region. There are nevertheless very real economies of scale in production. The extent of these economies may be debated, but that they exist can be shown by simple consideration of physical laws. During the brewing process the beer must spend varying amounts of time in large containers such as brewkettles and aging tanks. The volume of these tanks increases with the cube of the diameter; the surface area of the tanks is a function of the square of the diameter. While some allowance must be made for the fact that larger tanks require thicker walls, the amount of beer that may be produced increases much faster than increases in the cost of plant construction. Such gains are echoed in several stages of production and the net effect is non-trivial.

There have been many estimates of the actual minimum efficient scale of a beer plant. Looking at "survivors," that is, plants which passed a market test and are in operation, suggests that 20 years ago minimum scale was around one million barrels a year. Judging from the size of new plants and allowing for slight changes in technology, the

consensus is that minimum scale is now over three and one-half million barrels a year (four to five million hectolitres) a year, as suggested by Industry, Science and Technology Canada. Twenty years ago a market of 13 million barrels was supplied by 48 plants, of which 30 were run by the three major companies alone. Today a market of 20 million barrels is served by over 50 plants, but this figure includes something like a dozen micro-breweries which have successfully carved a small specialty niche. In contrast, the average plant in the United States is producing two million barrels a year or about five times the amount of the average Canadian plant. It should be added that rated capacity is probably 25% higher in the United States than these figures indicate.

The inefficiency associated with relatively small plant size is revealed by productivity figures. The output in beer per employee in the United States is more than triple that in Canada. The dollar value in shipments per employee is also more than double south of the border, but not triple because beer is relatively more expensive to buy in Canada. (To be fair, input costs are also higher in Canada, owing to import restrictions on malting barley, among other factors.) That the productivity varies with size of plant is visible when comparing provincial data. In Ontario, in 1984, shipments per employee were about $290,000; in British Columbia the figure was about $180,000. In the former province, three plants employed over 500 people, in the latter, no plant did so.

The route by which the above noted regulations stimulate concentration in the industry is obvious. Faced with a limited geographic market, firms must find methods of reaching efficient scale besides simply expanding to new markets. Beer consumption per capita has been flat or declining in Canada, and advertising to reach new drinkers or encourage consumption is actively discouraged by government. To confound matters, there is evidence that beer is an "inferior good," in that individuals' consumption of beer drops as their income rises. Thus, to increase production, firms may either merge or acquire firms or brands, as has been the Canadian experience. Alternatively, brewers may wait for small firms to decline through attrition and expand their own firm production, i.e. capture market share, as has been the process in the United States. In any

event, small markets leave less room for expansion to economic scale, with increasing industry concentration as the result.

Further comments should be made about economies of scale. The existence of economies in production has been discussed, but it has also been shown that there may be statistically significant economies of scale in advertising. This captures the concept that national advertising of brands is cheaper in terms of returns to advertising than regional advertising for regional beers. A firm may have spatially distributed plants producing one brand, but be able to purchase national advertising at a more effective price (per unit sale generated) than a smaller firm in a smaller market. The suggestion is that one campaign operated nationwide sells more beer per advertising dollar than several campaigns for several labels in regional markets. While some allowance should be made for the fact that tastes do vary regionally, the hypothesis seems reasonable and has support in recent evidence from the United States. There, the largest firms have increased market share at a rate higher than would be expected, given the ratio of advertising expenditures to sales compared with that ratio for smaller firms. Larger firms again being favoured by the nature of the industry, a market tendency toward concentration is to be expected.

The plant location regulations obviously have the largest effects on industry structure, but other facets of regulation have negative impact on consumers, if not on the industry in general. Perhaps as compensation for inhibitive production restrictions, cooperative behaviour among firms has been tolerated and actively encouraged. While helping to make brewing profitable, many features of the industry structure and its regulation have the indirect effect of limiting consumer choice and raising prices. While contributing to the perhaps laudable goal of restricting alcohol consumption, it is not clear that such effects are genuinely desired by consumers. Examples follow.

In Ontario, distribution of beer has been regulated under the Liquor Control Act since 1927, which marked the end of prohibition in that province. Exercising its powers under the Act, the Liquor Control Board allowed the creation of the Brewers Warehouse Company, which now controls Brewers Retail, or the Beer Store, which holds a monopoly on

retail sale of beer for off-premise consumption. Beer can also be legally purchased directly at the factory gates, but this is only relevant for those who happen to live beside breweries. The Beer Store is a cooperative owned by the Ontario brewers and shows no favour toward any individual manufacturer - costs are allocated according to sales. The most notable feature of the Beer Store is its existence: such institutions are, to say the least, unusual in the world of retail. Another form of cooperation in the industry takes the form of joint ownership of some facilities for barley malting. Again, the toleration of such intra-industry cooperative practices may be a tacit recognition of the influence of government policies on input costs, but such practices are not usual in industry, although a parallel is to be found in airline sharing of reservation systems, discussed elsewhere. The effects of such practices are real and some of them will be discussed here.

The simple fact of a monopoly at the retail distribution level inhibits competitive approaches to sale. While it is somewhat redundant to say that monopoly inhibits competition, it is useful to point out that, for instance, allowing alternative points of sale might lend growth opportunities to companies more skilled at innovation in marketing and product delivery. Less directly, more numerous distribution centres would decrease the net cost to consumers of purchasing beer in terms of time, travel, convenience and simple preference. While apparently the Beer Store and systems like it are reasonably efficient, it is difficult to see how a distribution system established essentially by fiat could be more efficient than a system arrived at via market forces and consumer preference.

Centralization of retail distribution provides a convenient point for close monitoring by producers of the activities of their competitors. Price competition in beer is non-existent; even "premium" beers bear a more-or-less uniform price. Pricing changes occur at once for all brewers, and new brands never enter the market at less than the current base rate. Similarly, competition in packaging style, design and size is limited. While recent years have seen the introduction of different package sizes and a proliferation of bottle styles, most of the history

of the industry has seen packaging determined either by regulation or by industry agreement, as was the case with the recently defunct "brown stubby." Again, consumer choice is not at the head of the list of determining factors. The desirability of such forms of consumption-inducing competition is not clear, however, given aforementioned concerns about appropriate levels of alcohol consumption.

These aspects of beer distribution and others, such as the general refusal to sell out-of-province beers on an equitable basis, obviously serve to limit competition to some extent. Since such structural factors, acting in concert with provincial pricing and listing requirements, maintain prices above the competitive pricing regime, elements of inefficiency are preserved within the industry. In other words, small firms and small plants, or inefficient large plants, survive where they would not in the absence of such regulation or cooperative practices. This acts against the natural market tendency toward high industry concentration while maintaining the level of industry earnings - to the possible detriment of consumers. The productivity effects (efficiency or market considerations) are in fact much stronger if one accepts historical and current high levels of concentration as evidence.

Some discussion of specific levels of concentration is in order. The trend toward concentration began as the industry opened up in the 1930s when Canadian Breweries Limited, under the guiding hand of Mr. E.P. Taylor, set about a pattern of acquisition aimed at obtaining effective control of the Canadian industry. Success prevailed for some years and by the early 1950s the firm had close to 50% of the market. In 1954 the market share held by the four leading firms was 81.9%.(2) In the long run, however, Canadian Breweries failed to gain control of the market and the modern incarnation of the firm, Carling O'Keefe, has been in

(2) Concentration ratios are useful measures in this industry because of the small role played by imports. If imports were to play a large role in the market the level of concentration would obviously drop, simply because the market share of domestic producers would fall. Even if the majors in Canada held a large share, the negative effects of concentration - e.g. high prices - would disappear, because competition for share from foreign brewers would place an upper limit on prices.

third place for some years. The level of industry concentration, however, continued to rise. Market share of the top four firms was over 90% by 1958, and rose steadily to a maximum of 99.1% in 1979.

The level of concentration has decreased slightly in recent years, reflecting the success of regional brewers and the previously mentioned micro-breweries in some small markets. As their product is not normally pasteurized, and thus has a physically limited market, it is reasonable to argue that micro-breweries are not competing in the same market as the majors and thus should not influence our measure of concentration. The trend away from concentration, to the extent that it exists, stands anyway to be reversed with the pending merger of the second and third largest brewers, Molson Companies Limited and Carling O'Keefe Breweries of Canada Limited. Carling O'Keefe had been owned until 1987 by Rothman's Inc. (the Canadian subsidiary of what is essentially a South African controlled conglomerate) at which time the Canadian brewing unit was sold to Elders IXL Ltd. of Australia. Profit margins have weakened in recent years and the low productivity levels mentioned earlier have made consolidation essential, at least in the view of those involved in the prospective merger.

B. Possible Effects

The merger of Molson and Carling O'Keefe operations awaits the approval of both the Bureau of Competition Policy (Consumer and Corporate Affairs) and Investment Canada. Since the merged firm would be half owned by Elders IXL, Investment Canada considers the arrangement to be foreign acquisition of control of Canadian assets. Further, since it is above the threshold mandating examination by the agency, regulatory approval is required. Since the merger would bring a higher level of concentration to the Canadian industry, the Director of Investigation and Research, subject to the terms of the <u>Competition Act</u>, is required to review the arrangement. In determining the competitive effects of the merger, the Competition Tribunal will consider the role of inter-provincial and international barriers to trade, as required by section 65 of the <u>Competition Act</u>, shown here in Appendix Figure II.

The proposed merger would affect consumers indirectly and employees and competitors more directly. Each sector will bear some discussion.

Dealing first with employees, the firms involved have estimated a net workforce reduction of 1,400 as a result of the arrangement. Total industry employment is around 9,000 production workers. Reduction would take place as Molson plants would be shut in Lethbridge, Winnipeg and Toronto and Carling O'Keefe operations would be shut in Saskatoon, St. John's, Vancouver and Montreal. A hypothetical distribution of job reductions posited by Molson officials, would be 600 in Quebec, 500 in Ontario, 95 in British Columbia, 70 in Alberta and 35 in each of Newfoundland, Manitoba and Saskatchewan. These reductions would obviously take place as production was streamlined ("rationalized") and the new firm attempted to reach economic scale.

While obviously deleterious from a labour perspective, these adjustments are not without positive overtones. Most obviously, efficient industries tend to survive, and thus job losses in a rationalized industry could be presented as the lesser of two evils; the worst case scenario would be the failure of inefficient firms in the face of external competition. Less obvious is the fact that capital intensive industries tend to pay higher wages than others. Third, consumer benefits arising from the long run reduction in the price of beer would take the form of spending on alternative consumption, thus raising employment elsewhere. Finally, the current market leader, John Labatt Limited, has announced its intention to make capital investments, ultimately providing in the order of 1,000 new jobs, in an attempt to attain competitiveness under the new market regime. These investments, and similar proposals by Molson, will be made with an eye to increased penetration of the United States market, where some success has already been shown. Increased penetration of that market will have some positive impact on Canadian employment.

In fact, it is from the labour perspective that deregulation may be most helpful. As mentioned before, "cheap beer" is not likely to be forthcoming, but an efficient beer industry is a provider of secure jobs.

Productive employment is essential for the general wellbeing, and this is achieved by allocating our resources, which include people, where they may be employed most effectively. In other words, Canada benefits from an efficient industry even if such benefits do not proceed directly to consumers through lower prices. A related point should be made with respect to government tax policies. Even if cheap beer is not a desirable goal, a lower production cost leaves more room for the tax bite, and the resulting government revenues will presumably be used to the benefit of all the population.

The consumer will only see a direct benefit if price is in fact reduced as a result of rationalization (the concept of a price reduction here must include a slower rise in prices). As mentioned earlier, the distribution system is not such as to encourage price competition. Nevertheless, since the long run cost structure is the same for all firms, a more efficient process may be expected to bring net benefits to consumers in the form of lower price hikes. The worry is that increased concentration facilitates collusion (agreement to maintain high price levels); however, as long as there is any competition, or potential competition, we may expect that price will not stray far from the competitive regime. The extent of competition will likely be determined in future by external factors, and these will be discussed shortly.

The resulting market structure will be more cost effective, at least at the production level. As already pointed out, Labatt intends to make large capital investments in order to remain competitive in terms of production costs and Molson has stated that it will make similar investments in its plants that remain after restructuring. Obviously, provincial markets previously served by three firms, and at least as many plants, will have greater scale efficiencies when served by only two firms.(3) Such rationalization is a fairly direct method of escaping provincial restrictions on production, listing and inter-provincial shipment. To the same extent that such restrictions have heretofore

(3) Market share on a regional basis is shown (before and after the merger) in Appendix Figure III.

protected inefficiencies in production and distribution, international frustration has mounted over perceived and real restraint of entry by foreign competitors.

C. Trade Issues: the GATT, the EC and the U.S.

While the various regulatory features of brewing and distribution inhibit competition among domestic producers and in many cases keep competition within provincial borders, they serve also to discourage imports from foreign producers.(4) It is indeed difficult for domestic brewers to obtain a listing (opportunity for distribution by a provincial government board) outside their province of production, and when they do there still exist certain penalties. In the maritime provinces, out-of-province beers cost 50 cents more per dozen. In Quebec, such beer may be sold only in liquor stores, though that province's own beer may be purchased in grocery stores. It is normal in the western provinces for domestic beer to be distributed in "cold beer" stores, the preferred point of sale, while out-of-province beer is given no such treatment. Foreign brewers view these restrictions solely as protective measures for the Canadian industry, since they obviously place more restrictions on foreigners than on domestic producers.

It is rather difficult for a brewer outside Canada to gain equitable access. For instance, while any beer produced within the province will be listed as requested, a foreign brewer must apply for a listing of each size of each brand it wishes to distribute and must often delist one label in order to create a spot for another. When the brand is listed, it will typically face a discriminatory markup of from 10% to 50%. Needless to say, distribution in retail beer stores is either unlikely or, in some provinces, simply impossible.

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(4) Canadian beer faces no onerous restrictions on entry into other countries, or at least into the United States (other than a low tariff). The oft-cited example is the case of Oland's Moosehead label, which is one of the leading import beers in the United States, but is virtually unavailable in Canada outside Nova Scotia.

European countries have complained for years about the provincial practices that limit access to Canadian beer, wine and spirit markets. But in 1979 the provinces agreed that the following position could be presented at the Multilateral Trade Negotiations:

> Each Canadian provincial marketing agency for alcoholic beverages will entertain applications for listing of all foreign beverages on the basis of non-discrimination between foreign suppliers ... standards with respect to advertising, health and the safety of products will be applied in the same manner to imported as to domestic products.
>
> Canada, "Multilateral Trade Negotiations 1979: Canadian Participation", Queen's Printer, 1979, p. 98.

There has, of course, been no reduction in barriers to either international or inter-provincial trade. As a whole, the brewing industry has no position on inter-provincial trade barriers; some brewers benefit, others do not. But the European Community certainly regards those barriers as part and parcel of international trade barriers. As such, in 1987 the EC launched a protest to GATT against such barriers. That protest was upheld by the relevant GATT panel in late 1988 when provincial listing practices were found to be contrary to the GATT. This opened the possibility of countervailing or punitive measures on all Canadian trade under the GATT regulations, and Canada was compelled to make concessions. Wine listings were of the most interest to the EC, the wine lobby there being very strong and aware of the possibility of expansion in the Canadian market. The inclusion of beer, however, was a very likely winner for the EC under GATT, and thus substantially improved its negotiating position.

Accordingly, wine, and to some extent, liquor restrictions will be eased in the coming years as production in those sectors is rationalized and such rationalization will proceed apace, being necessitated already by the promulgation of the Canada-US Free Trade Agreement. Immediate pressure from the EC with respect to beer has been lessened somewhat, since prospects for European success in the Canadian market are not particularly high owing to transport costs etc. Nevertheless, the inequity of Canadian barriers is widely recognized, and a side letter from Canada to the EC has been formally (but privately)

presented and that appendant to the agreement with the EC will have some limited effects.

The letter states that Canada recognizes the need for correction of its beer pricing practices and that such correction will proceed as inter-provincial restrictions are eased. Talks between provincial ministers with relevant responsibilities have taken place, and a working group of federal and provincial officials of the various industry ministries has been established (co-chaired by Robert Knox of the federal department of Industry, Science and Technology). Willingness to reach agreement will be encouraged by the pressure induced by the pending Molson-Carling merger. If the merger were to be disallowed, inter-provincial trade would take on added importance, as the necessary rationalizations which militate toward merger could be facilitated by simply reducing trade barriers. And if the merger goes ahead, the same imperatives will be brought home to the provinces, and the same trade concessions will be thus encouraged. In either case, the post-consolidation industry will be in better condition to meet international competition.

A continuing fear in the industry is that the inter-provincial restrictions will be eased, thus enabling the aforementioned concessions to the EC. Innocent in and of itself, GATT requires that trade practices allowed between any particular member nations be extended to all member nations (an exemption is a policy such as a comprehensive free trade agreement, which may be undertaken on a bilateral basis). To be specific, concessions granted to the EC must be extended to the United States, and the industry south of the border is certainly following these events closely. Being aware of the probability of EC success under GATT, the United States had no reason to speak loudly about the exclusion of beer from the Canada-US FTA. This was also preferable from the Canadian perspective, because the flexibility of arrangements, especially with respect to time for adjustment, could reasonably be expected to be greater in dealing with the EC. Sooner or later, however, it is likely that Canadian brewers will face external competition in the domestic market.

The situation, then, is that market forces tend to encourage concentration and rationalization in the brewing industry. Regulatory

features exacerbate this tendency in some respects, and act in other ways to preserve inefficiencies. The overbearing market direction is nevertheless toward concentration, and in the presence of actual and potential competition this feature would seem to be to some extent desirable. The elimination of inter-provincial barriers would ameliorate the productivity situation without necessarily encouraging concentration, but it is not obvious that this alone, without consolidation or merger, would allow sufficient growth in productivity to meet external competition. It is these considerations which will provide the challenge of the coming decade to the brewing industry.

THE IMPERIAL OIL - TEXACO CANADA MERGER

On 20 January 1989, Imperial Oil announced it had entered into an agreement with the U.S. Texaco Inc. for the purchase of its 78% interest in Texaco Canada. Excluded from the deal were Texaco Canada's oil properties on Georges Bank off Nova Scotia, 348,000 acres of oilsands in Western Canada and offshore oil properties in Guinea Bissau, West Africa. These properties are to be transferred from Texaco Canada to Texaco Canada Petroleum Inc. Imperial has made commitments to offer continued employment to all Texaco Canada employees, and to keep all Texaco Canada employees and pensioners on existing benefit plans for two years, after which they would be transferred to the corresponding Imperial Oil benefit plans. In addition, Imperial has promised to invest "a major portion of upstream cashflow before debt servicing in upstream Canadian companies" (Imperial Oil press release, 26 January 1989), to offer for sale over the next five years at least $550 million of upstream assets and "to sell a significant portion thereof" (press release), as well as continuing research and development programs.

Imperial has indicated to the Director of Investigation and Research that it is willing to divest some service stations and bulk terminals if the Director feels such actions are necessary.

Texaco Canada operates two refineries, one in Halifax, N.S. and the other in Nanticoke, Ontario. Through local independent

wholesalers, it markets its petroleum to its 1,800 retail locations. Texaco Canada employs 3,200 workers. Imperial Oil employs 12,000 workers. Imperial operates five refineries in Dartmouth, N.S.; Montreal PQ (closed); Sarnia, Ont.; Strathcona, Alta; Ioco, B.C.; and Norman Wells, N.W.T. Imperial has 3,000 retail outlets, of which 900 are co-owned and 80 are co-operated. In addition, Imperial, through its ESSO and ENGRO labels, sells home heating oils and fertilizers. Imperial produces 2,000 tonnes per day of petrochemicals and 4,800 tonnes per day of agricultural chemicals. Both Imperial and Texaco have interests in various pipelines.

The merger would give Imperial a 28.2% share of the refining market compared to Petro Canada's 22.2%. Some industry analysts have suggested that Imperials's major motive in the acquisition of Texaco is Texaco's Nanticoke refinery, which, unlike Imperial's Sarnia plant, is very suitable for unleaded gasoline production.

The backdrop against which to view the Canadian petroleum industry is the OPEC price hikes of 1973 and later. The world price for crude oil determines the domestic price, how much oil is drilled in Canada and how much is left in the ground for future use. The OPEC price hike has led consumers to reduce their use of gasoline, at least until recently. This contradictory market environment, together with the small-sized Canadian market has resulted in a complicated set of economic relationships among the oil companies.

A refinery operating at its minimum average cost level of output would produce about 200,000 barrels per day. Though the current Canadian requirements could be met with seven or eight such plants, the actual number of refineries in Canada is 27. The four major refiners, Petro-Canada) Imperial, Shell and Texaco, market nationwide and own a total of 18 refineries. The regional refiners, Irving, Ultramar, Newfoundland, Suncor, Co-op, Chevron, Husky, Turbo and Parkland, serve regional markets. Apart from Husky with two refineries, each regional refiner operates just one refinery. The overall pattern resulting from the need for economic-sized plant and a stagnant market is of refiners having excess capacity in their refineries and finding it expensive to serve distant customers who may be closer to a competitor's refinery.

The refining industry worked out these problems by a system of inter-refiner supply agreements whereby a pair of refiners would supply each other's nearby customers. These agreements were essentially exchanges of equal gasoline volume without sidepayments.

In addition to supplying product for sale under their own brand name, some refiners have fighting brands, such as Texaco's Regent and Sunoco's Pronto, for the discount-price gas stations.

The independent gasoline retailers, e.g. Canadian Tire, Suny's, contract for supply on either a long-term or short-term basis with the refiners.

There is obviously a very tangled web of connections between the refining industry and the gasoline retailing industry. We present some evidence on retail market shares in Appendix Figures IV and V. The relationship between the major refiners has seemed too cozy to many observers. There have been attempts by refiners to control retail prices by consignment selling arrangements, to support dealers with outlets close to price discounters with special discounts and to discipline independents by squeezing or refusing to supply them. Some of these practices have been found abusive by the courts.

If they wish to allow this merger the competition watchdogs must decide if they should restructure the gasoline distribution sector (to reduce the possibility of anti-competitive practices), or should instead force a minimal divestiture of gas stations that are too close together, and rely on the general remedies of the Act to deal with any future anti-competitive behaviour. It should be noted that Texaco is less integrated than Imperial, so that the economically necessary level of vertical integration in the industry is open to discussion. Since the end of the National Energy Policy, there have been no restrictions on the importation of refined gasoline. This provides some base discipline on the pricing policies of the gasoline industry.

THE STONE CONTAINER - CONSOLIDATED BATHURST MERGER

There has been heightened interest recently in the Canadian pulp and paper industry. Such interest is not surprising given the role that industry plays in the economy - it employs more than 85,000 and generates over 10% of Canada's total exports excluding lumber products, which contribute a further 5%. Attention has been focused on recent acquisitions in the industry; some being domestic consolidations and others foreign acquisitions of control of Canadian firms. The most recent was the purchase in January of this year by Stone Container Corporation (of Chicago) of Consolidated-Bathurst Inc., previously controlled by Power Corp. of Montreal; it is that transaction which will be given special consideration here. This acquisition is of note because control of a large and hitherto Canadian firm will move to the United States; such transactions alarm those who fear the loss of domestic self-determination, and see such loss as a result of foreign investment.

A. The Pulp and Paper Industry

"Pulp and paper" here will be considered to include pulp (the raw material for paper, paperboard and container board etc.) and the various products of pulp (the aforementioned plus Kraft paper, newsprint, coated papers and boxboard etc.) but to exclude lumber and wood products. Most firms in the industry are integrated producers, in that they produce their own pulp or at least have facilities producing material for sale at various stages of production. It is common for a firm to have its own harvesting operation, mills for producing pulp, and mills at the same (or remote) locations for converting pulp to the various forms of paper and packaging or container products.

The volume of production is large by any standard: in 1986 the industry shipped \$4.3 billion in pulp, \$7.2 billion in newsprint, \$1.5 billion in paperboard and \$2.5 billion in other selected paper products. Growth has been very strong in recent years and these figures somewhat understate the current dollar value. Capacity utilization has been hovering for over two years around the 100% mark. Canada's production

capacity is huge: Canada holds 7% of world capacity in paper and paperboard (more if newsprint alone is considered) and 16% of world pulp capacity. These shares are expected to rise slightly in the next few years.

The industry is preponderantly export oriented: depending on the particular subsector, from 80% to 95% of shipments are exported. Canada is the world's largest exporter of newsprint with Canadian mills exporting $8.0 billion in newsprint in 1988. This included sales of seven million tonnes to the United States and that figure represented 57% of total consumption in the United States.

The concept lurking behind these figures is that the market in pulp and paper is an international one in which Canadian production plays a leading role. Trade is relatively unhindered in forest products of all types, tariffs being all but non-existent and institutional barriers limited. This is because most governments realize that deliberately to raise input costs by placing a duty on raw materials would be more counter-productive to the economy than any other tariff policy. In any event, trade flows proceed and a producer of pulp or newsprint must be prepared to meet price and quality competition from anywhere in the world from the moment such a producer decides to enter the market.

B. Ownership and Concentration

There are many pulp and paper firms in Canada, and many large ones: there are more than 20 with net sales over $100 million. This is not to say that there are not market leaders; in newsprint the top four firms produce about half of all shipments and the share is higher in paperboard but lower in pulp. But, as discussed above, the relevant market is an international one and open competition reigns. This means that concentration in the domestic market is not relevant (and, for that matter, non-existent) because the world market is the standard by which output share should be measured. It is impossible for one firm to charge a price higher than the prevailing market rate in the world market; the proliferation of firms in a virtually unregulated market ensures the domestic presence of competitive pricing.

There have, however, been recent moves toward consolidation in the industry, some domestically driven and others the result of foreign acquisitions in Canada. For instance, Canadian Pacific Ltd. merged Great Lakes Forest Products Ltd. and CIP Inc. in 1988, to create an integrated forest products company with sales over $2 billion. Fletcher Challenge of New Zealand merged Crown Forest Industries Inc. with British Columbia Forest Products Ltd. to create Fletcher Challenge Canada Ltd., whose size is similar to that of the new Canadian Pacific Forest Products Ltd. Also in 1988, Daishowa Canada Ltd., a Japanese firm, acquired Reed Canadian Holdings, to obtain a substantial presence in the growing Alberta forest industry. The most recent, of course, is the purchase by Stone Container Corporation of Consolidated-Bathurst, announced on 26 January 1989 and approved by Investment Canada on 1 March. With sales of $2.4 billion, Consolidated-Bathurst was the fourth-largest in the Canadian market before the recent spate of consolidations.

As mentioned before, concentration is of no particular concern in this industry. Market power by the leaders is limited and this is easily demonstrated. When, for instance, Abitibi-Price announces a price increase in the North American newsprint market (and Abitibi-Price is usually the leader in such announcements, being the largest single producer), it is tacitly expressing its view that cost and demand conditions support an upward shift. What happens, however, is that other firms and Abitibi-Price itself engage in persistent discounting in efforts to retain their market share. There is no price movement that "sticks" until all firms find that profitability can no longer be maintained under the previous pricing regime. Such a process constitutes the best evidence that price competition dominates the market.

Of some concern is the issue of foreign ownership. The Canadian pulp and paper industry, unlike most other large industries, is predominately Canadian owned and about two thirds of Canadian capacity is domestically controlled (the figure will drop by about 7% as a result of the Stone acquisition - see Appendix Figure VI). Even so, the question of the desired level of foreign ownership in Canada remains.

Historically, Canada has been dependent on foreign supplies of investment capital. This is normal for a large and thinly populated country, and steady capital inflows have indeed been the norm since and before Confederation. Capital is necessary in order to exploit available resources and adopt technologies enabling their efficient utilization. What is not said as often is that capital is required to make use of Canada's most important resource, its population. To say that capital is necessary to exploit the population is to say that investment is necessary to create jobs, a goal which is generally acknowledged to be desirable.

Concerns about high levels of foreign ownership have led to restrictions on direct acquisition (the now-defunct Foreign Investment Review Agency was the responsible body during the most restrictive period) but the demand for capital has not abated. While FIRA did exert a certain chilling effect on inflows, a direct result was the growth of portfolio as opposed to direct or controlling investment. There has been substantial easing of restrictions on foreign investment, but still at issue is the question of control of Canadian resources.

Foreign ownership is often said to misdirect the use of Canadian resources for the benefit of outsiders, to limit Canadian control by placing foreign management in senior positions, to undertake research abroad instead of in Canada and to remove profits which might otherwise have been reinvested in the domestic economy. There is little evidence to support these contentions, but to be hesitant about the loss of domestic control over Canadian firms is not unreasonable.

C. Productivity Issues

Profitability has been high in the Canadian industry in recent years; return on equity in 1987 averaged something like 20% among the top 20 firms. This has been a result of extraordinary demand coupled with favourable exchange rates and low input costs. Industry analysts say that earnings have, however, peaked, and that in the face of stiff competition from southern hemisphere producers and an appreciating dollar,

profits may be expected to fall. (To be fair to the industry, analysts have been predicting such crises for two years or more.)

The advantage held by the Canadian pulp and paper industry is its low input costs (wood and energy) and high quality of raw materials. Black spruce contains the long, sturdy fibre demanded for quality newsprint and fine papers, and the ability to clear-cut such trees has given domestic producers significant cost advantages. Modern technology has posed something of a problem in that fine quality papers may now be produced using lower quality fibre from suppliers such as Brazil, Georgia or Florida, where regeneration times are much shorter. Canadian mills are not, in general, especially productive in terms of the cost per unit output, and some modernization is in order.

We are returned, then, to the issue of capital investment in the industry. Restructuring and rationalization are taking place, as evidenced by the consolidation activities of the domestically controlled producers. Foreign firms are also making investments in the production facilities of their newly acquired firms; it was to some degree the prospect of a $1 billion investment by Stone Container in Canadian operations that encouraged the approval of the transaction by Investment Canada. If the analysts are correct, such investments will be necessary to solidify the forest products sector and preserve its productivity.

To summarize then, despite recent trends to consolidation in the pulp and paper sector, concentration is not an issue here, owing to the global nature of the industry. The world market may be described as (perfectly) competitive; contestability exists in the domestic market. Foreign ownership may be an issue at some time, but the industry is for the most part Canadian controlled. Capital requirements mean that over-hasty rejections of foreign participation in industry should be guarded against. There may be policy questions about such ownership, but recent events, included the sale of Consolidated-Bathurst to Stone Container, do not lend any particular urgency to such discussions.

CONCENTRATION

The recent upturn in merger activity has sparked a debate on corporate concentration. Table 2 shows the changes in the percentage of sales, assets and profits for Canadian firms.

TABLE 2

Changes in the Relative Shares of Financial Characteristics of Leading Enterprises (1975-1986)

Ranking	Sales	Assets	Profits
Leading 25	+1.4	+5.9	+7.6
26 to 100	-2.0	-1.3	-3.8
101 to 500	-2.2	-4.1	-6.1
501 to 1,000	-0.9	-3.1	-0.8
Remaining	+3.6	+0.8	+3.2

Source: W. Krause and J. Lothian, Canadian Economic Observer, January 1989.

This table may be interpreted in this way: the percentage of assets held by the top 25 firms in the Canadian economy increased by 5.9 percentage points between 1975 and 1986, going, in fact, from nearly 29% to just over 35%. Some caution should be exercised in using this table because the share figures are affected by the business cycle. Whether one looks at sales, assets or profits, the same divergent picture emerges: both the largest 25 and the smallest firms (those ranked below 1000) have increased their shares of sales assets and profits, while the percentage shares of the firms ranked between 26 and 1000 have declined. How one reacts to this picture depends upon one's view of concentration. Concentration has grown at the top, but at the same time as there has been a relative increase in the economic health of smaller firms. Any tendency towards concentration is not uniform and does not seem to have harmed the opportunities available for smaller firms.

POLICY QUESTIONS

The Competition Act has been in operation for only two years. The Act left considerable responsibility in the hands of the watchdogs; in particular they have to reach a workable definition of "lessen competition substantially" and to decide the size of gains in efficiency necessary to outweigh a substantial lessening of competition. The airlines, brewing and oil decisions should be quite illuminating on these questions.

There has been considerable public debate on how the Director's function has developed so far. Mr. Goldman has, after consultations and public discussions, decided to follow a recommendation of the Nielsen Task Force and operate merger review as a compliance program, where the Director attempts to negotiate with companies in redesigning merger proposals rather than immediately forwarding an initially unacceptable proposal to the Tribunal. Some members of the business community have criticized the Director for taking too long to reach a decision and then issuing a "letter of comfort" rather than a final approval. Some public interest groups have complained that too much of the process now takes place behind closed doors. These are important questions but they can best be settled after an independent review after a few more years of experience with the system.

Public debate has raised the question of whether the current merger boom ought to be allowed to run its course or whether immediate intervention is needed. There is considerable disagreement among economists on the level of economic benefit resulting from mergers. Economists have chosen different approaches to measurement, such as looking at stock-market data, accounting data or sales and employment data. As well, different statistical procedures seem to give different numerical results. Overall, there is no evidence that mergers are usually harmful to the merging firms, but it is an open question whether mergers are benign or beneficial in general. The economic costs or benefits of a strong anti-merger policy are uncertain.

The merger boom in the US has led to a spate of newspaper and magazine articles pointing out various problems. There have been cases where pension fund surpluses have been appropriated for the benefit of the shareholders of the acquiring firm. In the U.S., in general, pension contributions are made by the firm rather than jointly by the firm and worker as is the Canadian case. This would normally be nothing more than a trivial accounting difference without serious implications. After all, the worker never sees the employee contributions and the employer pays in total both the employer and employee contributions. Some U.S. courts have ruled that the employers own the surplus because their names are on the contributions. In Canada, Quebec and Manitoba have legislation and the federal government and Ontario have issued regulations all designed to protect pension surpluses to some degree. Every pension fund is a special case depending on the plan itself, the deed of trust and the provincial legislation or regulations. However, Canadian workers do have better protection than American workers. Under U.S. legislation it is possible to take over a firm and declare bankruptcy to break labour contracts, using Chapter 11 protection of the Bankruptcy Code, while continuing business operations. Canada does not have such legal provisions.

Increasing corporate concentration does present some policy concerns in a democracy. The major worry is that concentrations of economic power will capture the political agenda, subverting the course of popular democracy. As well as influencing the general direction of government policy to make it pro-business, the business sector competes for grants, subsidies, tax breaks, and government contracts. It should be noted that creating a pro-business climate is a goal to which all business groups could reasonably subscribe, but the competition for grants and so on puts one corporation in conflict with another.

Big business may exercise its economic power in secret without public accountability, according to critics. By spending heavily to influence policy and decisions, big business makes the political process more expensive for all groups that wish to gain the ears of politicians and bureaucrats, since citizens' groups and other representative groups have to spend more to make a credible presentation of their point of view. Large

APPENDIX TABLE 1

NUMBER OF MERGERS AND ACQUISITIONS BY TYPE, BY COUNTRY

	Canada, 1970 - 1986			Germany, 1970 - 1986			Japan, 1970 - 1985 (f) (g)				United States, 1970 - 1986 (l)		
Year	Total	Horizontal	Large	Total	Horizontal	Large	Total mergers	Horizontal	Large	Number of Acquisitions	Total	Large	Value Paid $ Billions
		(a)	(b)	(c)	(d)	(e)	(h)	(d) (i)	(j)	(k)		(m)	(n)
1970	427	224	n.a.	305	n.a.	n.a.	1,147	677	47	413	1,318	n.a.	n.a.
1971	388	215	n.a.	220	n.a.	n.a.	1,178	627	39	449	1,269	n.a.	n.a.
1972	429	238	n.a.	269	n.a.	n.a.	1,184	518	45	452	1,263	n.a.	n.a.
1973	352	227	n.a.	242	n.a.	n.a.	1,028	399	37	443	1,064	n.a.	n.a.
1974	296	158	n.a.	318	235	n.a.	995	372	35	420	926	n.a.	n.a.
1975	264	179	3	448	336	n.a.	957	390	36	429	981	6	n.a.
1976	313	214	3	453	283	n.a.	941	365	32	511	1,145	16	n.a.
1977	395	261	1	554	367	n.a.	1,011	408	37	646	1,209	37	n.a.
1978	449	231	9	558	396	n.a.	898	415	32	595	1,452	36	n.a.
1979	511	290	9	602	386	n.a.	871	373	38	611	1,526	61	34.2
1980	414	220	13	635	401	n.a.	961	576	33	680	1,565	59	33.1
1981	491	302	23	618	387	41	1,044	557	462	771	2,326	119	67.0
1982	576	284	2	603	376	48	1,040	468	178	815	2,295	107	60.4
1983	628	352	3	506	335	29	1,020	526	436	702	2,345	108	52.3
1984	641	345	4	575	377	29	1,096	478	470	790	3,064	189	125.2
1985	714	370	16	709	449	52	1,113	581	538	807	3,165	243	139.1
1986	953	383	42	802	571	65	n.a.	n.a.	n.a.	n.a.	4,022	352	190.0

Notes: See following page.

Source: Marfels, C. "Aggregate Concentration in International Perspective..." in R.S. Khemani et al., "Mergers, Corporate Concentration and Power in Canada", Institute for Research on Public Policy, Halifax, 1988.

corporations can also marshal allied groups who they think will have a better public image. Workers are routinely bussed onto Parliament Hill to protest the government's failure to provide a subsidy or its awarding a contract elsewhere. Large corporations indulge in advocacy advertising, legal challenges to both the government and regulatory bodies and sponsor research groups and think-tanks sympathetic to their interests. Large corporations, through the friendly process of consultation, help define which policy options are feasible. The two arguments are that business is disproportionately powerful and that big business is even more disproportionately powerful.

The first argument is hard to evaluate; anecdotal evidence can always be found on both sides. For example, it is widely held that a two-page pro-free trade newspaper advertisement by a business interest group shortly before the last election hurt the Progressive Conservatives. On the other hand, the last Parliament saw a Private Member's bill restricting cigarette advertising passed in the face of considerable lobbying by the tobacco manufacturers, showing that citizens' groups can win against a powerful business.

The second argument assumes that, in lobbying, bigger is better. Why is it profitable for a large conglomerate corporation to spend more on lobbying than its constituent firms would spend individually on the same activity? Why can a single constituent firm convince its parent corporation to spend more on lobbying to promote the single firm's interests than it would be profitable for the single firm to spend itself? Large conglomorate corporations which take over a number of smaller firms must mediate conflicting interests among their constituent firms, and thus will find it harder to speak with a unified voice. It is difficult to think of why large conglomerates would find it profitable to undertake disproportionately more lobbying and influence-buying than their separate constituent parts. Indeed, large conglomerates may find it harder to decide what lobbying is in their aggregate interest.

NOTES TO APPENDIX TABLE I

(a) Based on two-digit industries for manufacturing and one-digit divisions for other sectors.

(b) Value of transactions over $100 million.

(c) Notifications to the Federal Cartel Bureau according to Paragraph 23, Act Against Restraints of Competition.

(d) Including market-extension mergers.

(e) Acquired firm's sales over DM 500 million.

(f) Notifications to the Fair Trade Commission; excluding acquisitions of stock and acquisitions by foreign firms.

(g) Fiscal Year.

(h) Consolidation of two or more firms (Section 15(2) of the Antimonopoly Act).

(i) These figures refer to the number of firms involved in mergers. This makes comparison with other countries difficult, since some mergers involve more than two firms, making an accurate count impossible.

(j) Capital of the merger partners over 1 billion yen.

(k) Transfers of business (Section 16 of the Antimonopoly Act).

(l) Completed transactions at end of year, value of transaction of $1 million or more; transfers of at least 5 per cent of a firm's assets or equity.

(m) Over $100 million paid for acquired firm.

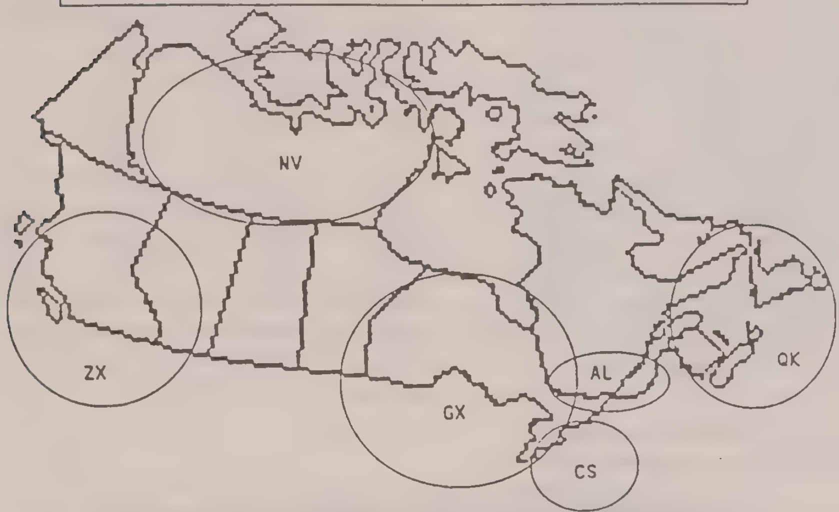
(n) Includes only transactions for which valuation data are publicly recorded.

APPENDIX FIGURE 1

Level I Airline Affiliations

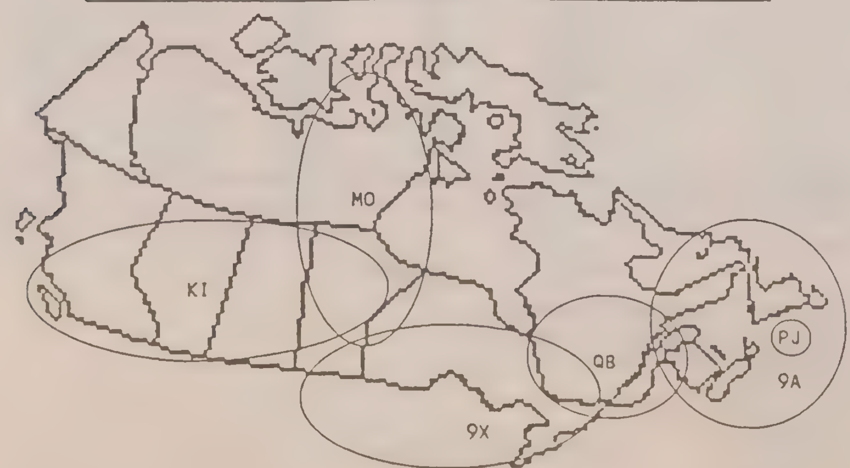
Air Canada

AFFILIATES	RELATIONSHIP
Air Ontario (GX)	75 % owned
Air BC (ZX)	100 % owned
Air Nova (QK)	49 % owned
Air Alliance (AL)	75 % owned
Northwest Territorial (NV)	90 % owned
Air Toronto (CS) (Commuter Express)	codesharing



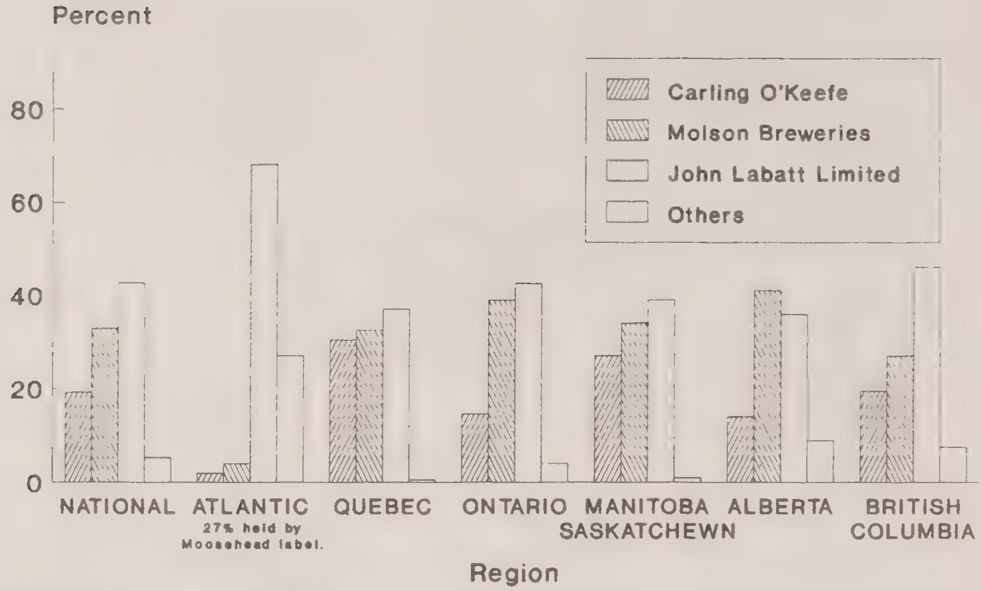
Canadian Airlines International

AFFILIATES	RELATIONSHIP
Inter-Canaidan (QB) (includes Quebecair Quebecair Inter Nordair Metro)	35 % owned
Ontario Express (9X)	49 % owned
Time Air (KI) (includes Norcanair)	46 % owned
Air Atlantic (9A)	45 % owned
Calm Air Int'l (MO)	45 % owned
Air St. Pierre (PJ)	codesharing



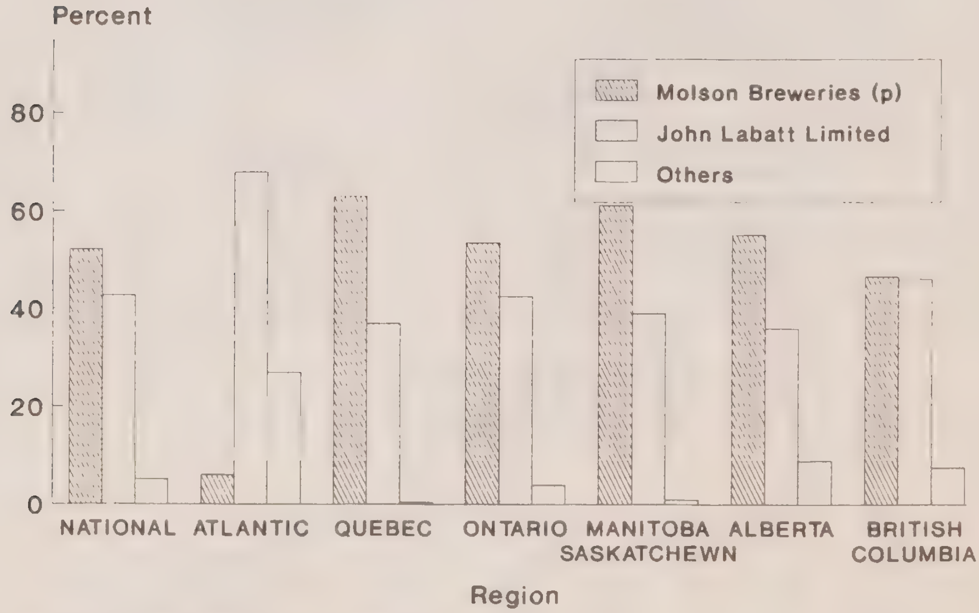
APPENDIX FIGURE II

The Brewing Industry
Canadian Market Share by Firm
Percent of Market - 1988



Source: The Financial Times and
Ian Osler, Prudential-Bache Securities.

Hypothetical Market Share After Merger
(derived from above shares)



(p) predicted: assuming shares hold for brands held by separate firms before the occurrence of the merger.

APPENDIX FIGURE III Section 65, THE COMPETITION ACT, 1986

i

Factors to be considered regarding prevention or lessening of competition

65. In determining, for the purpose of section 64, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially, the Tribunal may have regard to the following factors:

(*a*) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the parties to the merger or proposed merger;

(*b*) whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail;

(*c*) the extent to which acceptable substitutes for products supplied by the parties to the merger or proposed merger are or are likely to be available;

(*d*) any barriers to entry into a market, including

(i) tariff and non-tariff barriers to international trade,

(ii) interprovincial barriers to trade, and

(iii) regulatory control over entry,

and any effect of the merger or proposed merger on such barriers;

(*e*) the extent to which effective competition remains or would remain in a market that is or would be affected by the merger or proposed merger;

(*f*) any likelihood that the merger or proposed merger will or would result in the removal of a vigorous and effective competitor;

(*g*) the nature and extent of change and innovation in a relevant market; and

(*h*) any other factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger.

Éléments à considérer

65. Lorsqu'il détermine, aux fins de l'article 64, si un fusionnement, réalisé ou proposé, empêche ou diminue sensiblement la concurrence, ou s'il aura vraisemblablement cet effet, le Tribunal peut tenir compte des facteurs suivants :

a) la mesure dans laquelle des produits ou des concurrents étrangers assurent ou assureront vraisemblablement une concurrence réelle aux entreprises des parties au fusionnement réalisé ou proposé;

b) la déconfiture, ou la déconfiture vraisemblable de l'entreprise ou d'une partie de l'entreprise d'une partie au fusionnement réalisé ou proposé;

c) la mesure dans laquelle sont ou seront vraisemblablement disponibles des produits pouvant servir de substituts acceptables à ceux fournis par les parties au fusionnement réalisé ou proposé;

d) les entraves à l'accès à un marché, notamment :

(i) les barrières tarifaires et non tarifaires au commerce international,

(ii) les barrières interprovinciales au commerce,

(iii) la réglementation de cet accès

et tous les effets du fusionnement, réalisé ou proposé, sur ces entraves;

e) la mesure dans laquelle il y a ou il y aurait encore de la concurrence réelle dans un marché qui est ou serait touché par le fusionnement réalisé ou proposé;

f) la possibilité que le fusionnement réalisé ou proposé entraîne ou puisse entraîner la disparition d'un concurrent dynamique et efficace;

(*g*) la nature et la portée des changements et des innovations sur un marché pertinent;

h) tout autre facteur pertinent à la concurrence dans un marché qui est ou serait touché par le fusionnement réalisé ou proposé.

Factors to be considered regarding prevention or lessening of competition

65. In determining, for the purpose of section 64, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially, the Tribunal may have regard to the following factors:

(*a*) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the parties to the merger or proposed merger;

(*b*) whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail;

(*c*) the extent to which acceptable substitutes for products supplied by the parties to the merger or proposed merger are or are likely to be available;

(*d*) any barriers to entry into a market, including

(i) tariff and non-tariff barriers to international trade,

(ii) interprovincial barriers to trade, and

(iii) regulatory control over entry,

and any effect of the merger or proposed merger on such barriers;

(*e*) the extent to which effective competition remains or would remain in a market that is or would be affected by the merger or proposed merger;

(*f*) any likelihood that the merger or proposed merger will or would result in the removal of a vigorous and effective competitor;

(*g*) the nature and extent of change and innovation in a relevant market; and

(*h*) any other factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger.

Éléments à considérer

65. Lorsqu'il détermine, aux fins de l'article 64, si un fusionnement, réalisé ou proposé, empêche ou diminue sensiblement la concurrence, ou s'il aura vraisemblablement cet effet, le Tribunal peut tenir compte des facteurs suivants :

a) la mesure dans laquelle des produits ou des concurrents étrangers assurent ou assureront vraisemblablement une concurrence réelle aux entreprises des parties au fusionnement réalisé ou proposé;

b) la déconfiture, ou la déconfiture vraisemblable de l'entreprise ou d'une partie de l'entreprise d'une partie au fusionnement réalisé ou proposé;

c) la mesure dans laquelle sont ou seront vraisemblablement disponibles des produits pouvant servir de substituts acceptables à ceux fournis par les parties au fusionnement réalisé ou proposé;

d) les entraves à l'accès à un marché, notamment :

(i) les barrières tarifaires et non tarifaires au commerce international,

(ii) les barrières interprovinciales au commerce,

(iii) la réglementation de cet accès

et tous les effets du fusionnement, réalisé ou proposé, sur ces entraves;

e) la mesure dans laquelle il y a ou il y aurait encore de la concurrence réelle dans un marché qui est ou serait touché par le fusionnement réalisé ou proposé;

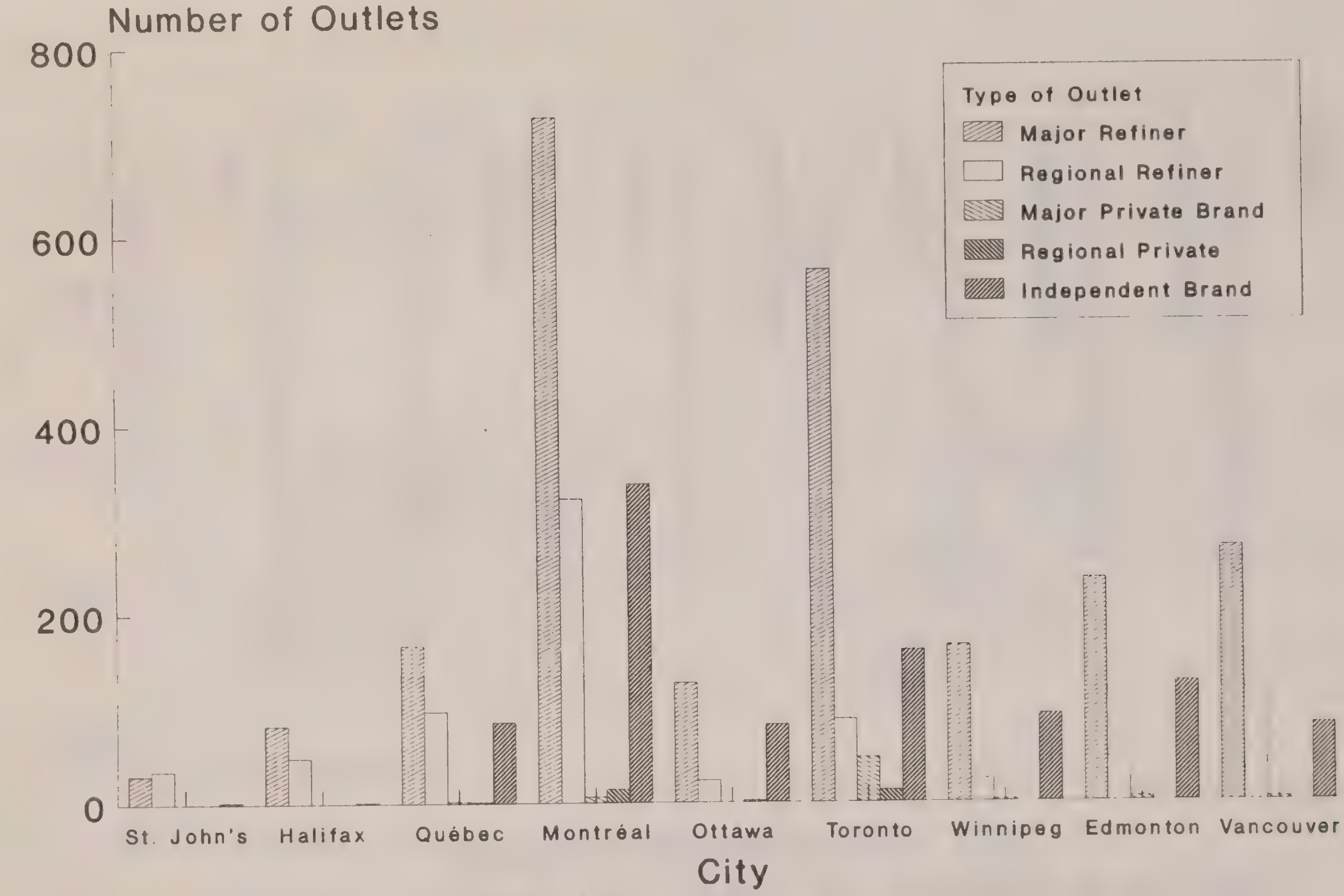
f) la possibilité que le fusionnement réalisé ou proposé entraîne ou puisse entraîner la disparition d'un concurrent dynamique et efficace;

(*g*) la nature et la portée des changements et des innovations sur un marché pertinent;

h) tout autre facteur pertinent à la concurrence dans un marché qui est ou serait touché par le fusionnement réalisé ou proposé.

APPENDIX FIGURE IV

Distribution of Outlets by Type and City
Market Share Summary, 1987

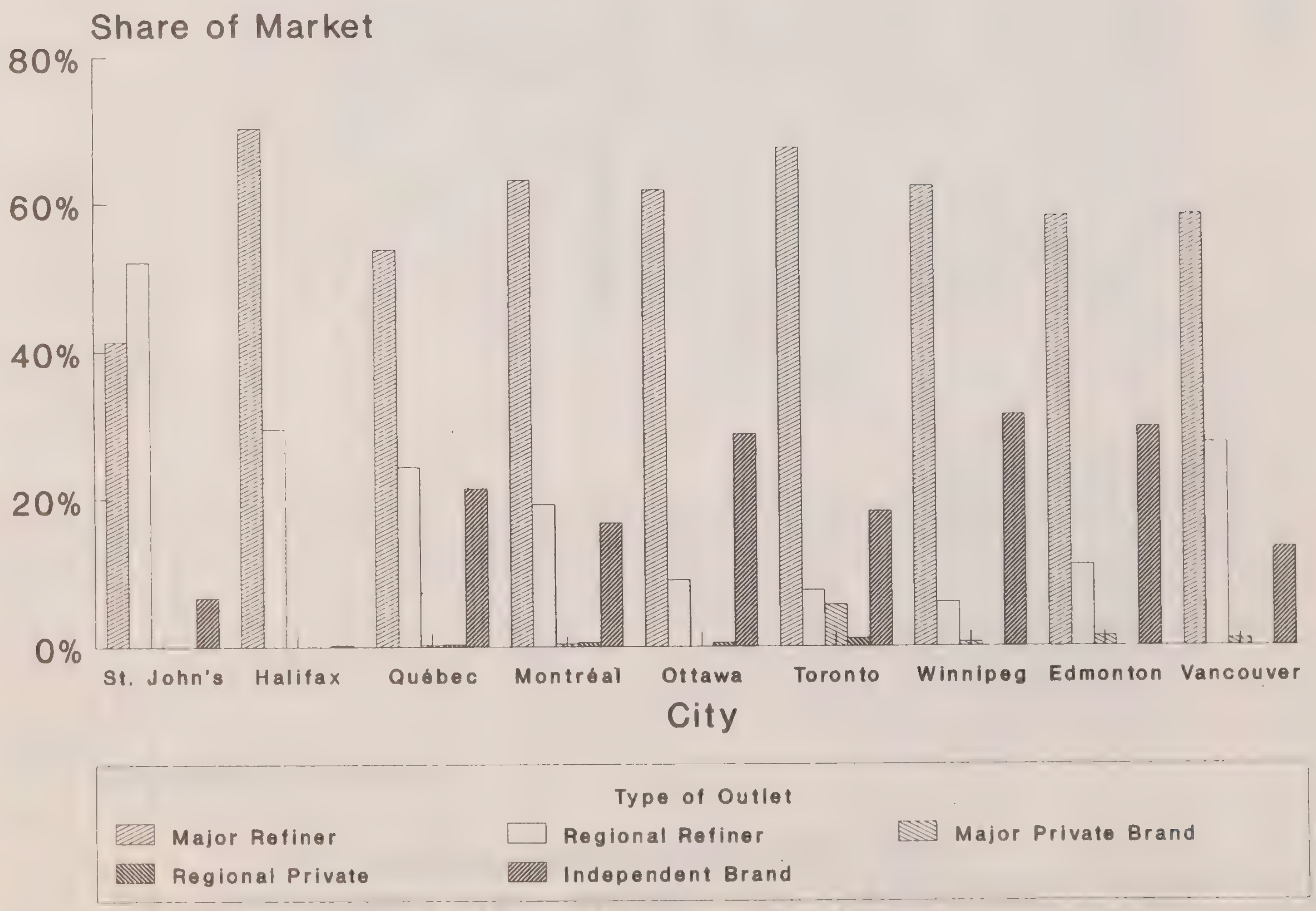


Source: Energy, Mines and Resources.

APPENDIX FIGURE V

Market Share by Type of Outlet and City

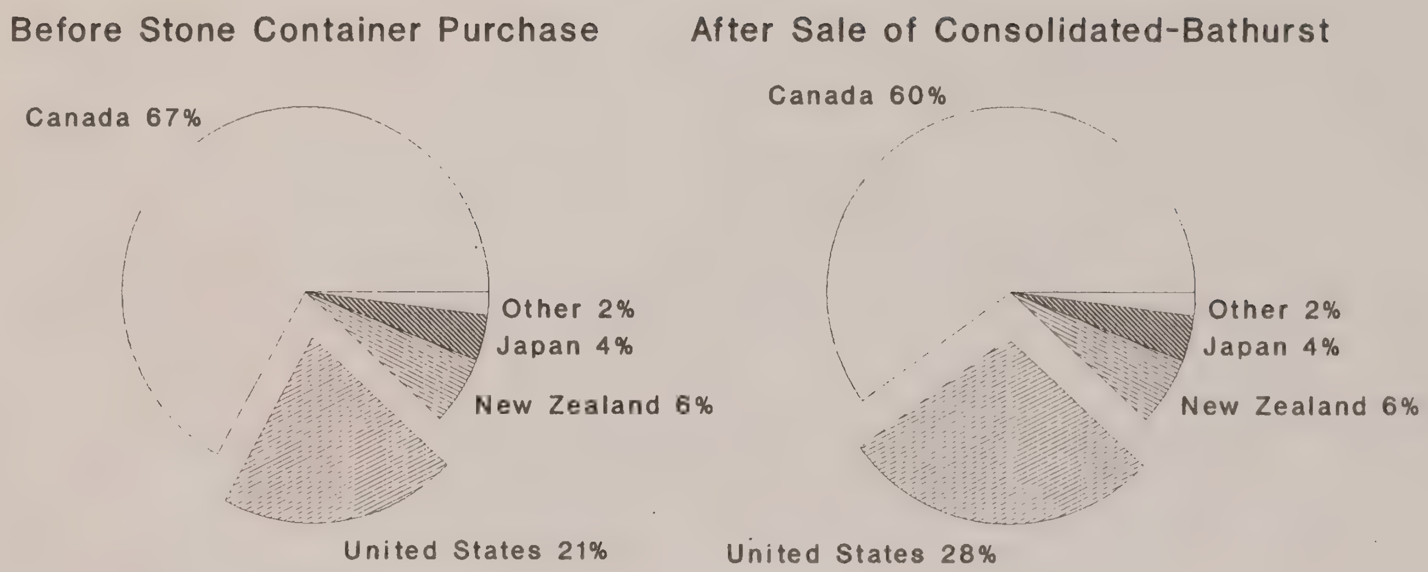
Market Share Summary, 1987



Source: Energy Mines and Resources.

APPENDIX FIGURE VI

Control of Pulp and Paper Capacity in Canada - 1989



Source: The Globe and Mail and the Canadian Paper Analyst.